Illinois Liquor Control Commission
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M E M O R A N D U M

TO: Commissioners, ILCC

FROM: Rick Haymaker, Chief Legal Counsel, ILCC

CC: Gloria Materre, Executive Director, ILCC
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DATE: August 14, 2014

SUBJECT: Analysis of Industry Private Label Rule Proposal

At the July 16, 2014 Commission Meeting, Chairman Schnorf asked that Michael Moses, partner of the Siegel and Moses Law Firm, draft a rule that would support counsel's argument that retailer private labeling is and should continue to be legal under the Illinois Liquor Control Act. The Chairman requested that I draft a summary and response to Mr. Moses' proposal which follows herein.

A. Legal Staff Position

Based on the responses that the staff has received from the initial published draft of a Private Labeling Rule, Commission staff now agrees with other industry members that legislation is needed to clarify the law related to private labeling. Absent legislative action, however, the plain language of the Liquor Control Act is clear and unambiguous to prohibit exclusive retailer brands.

B. Moses Proposal Summary

The Moses proposal defines a "brand or trade name", "Private Brand Label" and two circumstances under which a retailer's name or retailer controlled name can appear on a brand in Illinois. The definitions need no summary. The proposal thoroughly defines a "brand or trade name" and creates a definition of a "Private Brand Label". The two circumstances can be summarized as follows: 1. Private Brand Label - An alcoholic beverage with a Private Brand Label is a retailer owned or controlled brand which is exclusively sold to the retailer which owns or controls the brand (hereinafter in this memo, the term "Private Brand Label" refers to this definition"); 2. Non-Private Brand Label - Separately, a manufacturer could be contractually authorized to use the retailer's name

on an alcoholic beverage which in turn would be sold through a distributor for general distribution to all retailers. In the case of the Non-Private Brand Label, the manufacturer pays a royalty to the retailer for the use of the retailers name on the manufactured product. The proposal states that both circumstances are permitted by the Act.

C. Analysis/Comment

The proposal is deficient because: 1. Paragraphs 5-6 lack clarity in distinguishing the differences between the two circumstances of the use of a retailer's name on a brand; 2. Paragraphs 4-5 which expressly authorize exclusive sales of Product Brand Labels to retailers directly contradict the Act's prohibition against exclusive brand sales to retailers (235 ILCS 5/6-17.1) and authorize the Commission to act outside of its rulemaking authority; 3. Paragraph 6 which permits the use of a retailer's name on a generally distributed brand, could violate the "of value" provisions the Act by permitting a manufacturer to give advertising value to a retailer (this issue, however, is outside the scope of the central analysis of this memo and will only be addressed briefly unless further analysis is requested by the Commission).

1. A Rule Would Need to More Clearly Distinguish between the Concept of "Private Brand Labels" and "Use of Retailer's Name" as Cited in Proposal Paragraphs 5 and 6

Distinguishing Private Brand Labeling from the use of retailer name on a brand requires the distinctions to be made in the definitions of each of the two scenarios. The Legal Staff has no general objection to the definitions of "brand or trade name" in Paragraph 1 of the proposal and "Private Brand Labels" in paragraph 2-3. Nevertheless, the distinctions that the proposal makes in Paragraphs 5-6 are important distinctions. Thus, if the Commission expressly permitted a manufacturer to use a retailer's name on a bottle in which the manufacturer paid the retailer a royalty, it should be defined in either a separate rule or in a separate definition.

2. Proposal Paragraphs 4 and 5 of the Proposal Directly Contradict the Act and Fall Outside of the Commission's Rulemaking Authority.

Paragraphs 4 and 5 of the rule proposal ask the Commission to: 1. Violate the most basic rules of statutory construction; and 2. Act outside its rulemaking authority, notwithstanding counsel's attempt to justify the proposal through unsubstantiated past practices and "legislative acquiescence".

a. Basic Rules of Statutory Construction Prohibit Private Brand Labeling.

First, there is no need to over-complicate the construction of the statute which clearly prohibits retailer brand exclusivity. The Commission is well aware having decided prior matters that there is a legion of case law that state the following premise: The best evidence of legislative intent is through a plain reading of the statute. Unless there is ambiguity in the language of the statute, there is no need for the Commission to go beyond the words of the statute to find meaning.

As related to retailer brand exclusivity, the Act unambiguously states the following:

> A distributor or importing distributor designated as a distributor or importing distributor for alcoholic liquor within a designated geographic area or areas under Section 6-9 of this Act **shall use its best efforts to make available for sale to retail licensees, in its**

> **designated geographic area or areas, <u>each brand of alcoholic liquor</u> which the distributor or the importing distributor has been authorized to distribute. Nothing in this Section prohibits a distributor or importing distributor from establishing purchase requirements unless the requirements have the effect of excluding a majority of the retail licensees in the designated geographic area or areas from purchasing <u>the alcoholic liquor</u>. (emphasis added)**

There is no ambiguity in the language of the above paragraph which clearly prohibits a distributor from illegally discriminating against a retailer because the language requires a distributor "best efforts to make available for sale to retail licensees. . . **<u>each brand</u>** of alcoholic liquor." Any ambiguity that may arise by the use of the term "best efforts" is clarified by the last sentence of the section which states that a distributor's actions cannot "have the effect of excluding a majority of the retail licensees . . . from purchasing the alcoholic liquor." While this Section may not mandate that a distributor generally sell every brand alcoholic liquor to all retailers in its territory, the language is clear that a distributor not exclusively sell a **<u>brand</u>** to one retailer. In his proposal, counsel offers a different construction of the brand discrimination statute based on legislative history/intent and past practices or "longstanding permissibility". The rules of statutory construction, however, do not allow the presentation of arguments of legislative history or past practices when the statute, on its face, is clear and unambiguous. Nevertheless, for the sake of argument, assuming that the Commission takes into account legislative history and past practices, it does not change the conclusion that 235 ILCS 5/6-17.1 prohibits brand exclusivity.

First, as to legislative intent, counsel argues that the intent of 6-17.1 is to ensure that distributors make best efforts to provide service to all retailers **<u>generally</u>** without regard to ensuring that a specific brand is equally distributed. If that interpretation was accurate, the legislature would not have included the phrase "each brand" when requiring a distributor to use best efforts. The statute would have used other language to ensure serviceability. In fact, in 235 ILCS 5/6-9.1, the legislature does use different language to ensure serviceability by stating:

> A distributor of wine or spirits shall deliver to any retailer within any geographic area in which that distributor has been granted by a wholesaler the right to sell its trademark, brand, or name at least once every 2 weeks if (i) in the case of a retailer located in a county with a population of at least 3,000,000 inhabitants or in a county adjacent to a county with at least 3,000,000 inhabitants, the retailer agrees to purchase at least $200 of wine or spirits from the distributor every 2 weeks; or (ii) in the case of a retailer located in a county with a population of less than 3,000,000 that is not adjacent to a county with a population of at least 3,000,000 inhabitants, the retailer agrees to purchase at least $50 of wine or spirits from the distributor every 2 weeks.

This Section of the Act ensures that any retailer can obtain regular wine and spirits deliveries every two weeks if they place a minimum order. Why then would it be necessary to ensure general serviceability in 5/6-17.1 if it is already required in 5/6-9.1? Therefore, in addition to the plain

language of 5/6-17.1, if the Act is read in its totality, it is clear that Section 5/6-9.1 ensures serviceability while 5/6-17.1 guards against retail brand discrimination.

Also, counsel suggests that even if 5/6-17.1 was intended to apply to specific brands, that the Act only permits a distributor to sell brands that it is "authorized to distribute" as required in 5/6-17.1. It, therefore, follows that if a retailer owns a brand and through its agreement with a manufacturer (and, by extension, a distributor), restricts the sale of that brand to the brand owning retailer, then it would be permissible for the distributor to ignore its independent duty to ensure that it makes best efforts to make each brand available to all retailers.

Counsel's argument, however, is contrary to law and practice. If it is true that a provision in a manufacturer/retailer agreement could permit, by contract, retailer exclusive brands, then it would enable contractual provisions to trump the Liquor Control Act which expressly prohibit retailer brand exclusivity. Moreover, the Commission does not receive retailer specific brand authorizations when a manufacturer or distributor submits a registration statement to the Commission. Registration statements signed by the manufacturer or distributor assign the geographic territory in which the distributor is authorized to sell a brand. The authorization either defines a specific county, counties or, most commonly, assigns the entire State of Illinois as the authorized geographic territory. The registration assignment is not retailer specific and thus does not authorize a distributor to ignore its duty by selling a brand exclusively to a retailer.

In addition, while counsel makes an effort to argue that past practices and, hence, the "legislative acquiescence" to the past practices trump the plain language of the Act, his effort falls short of legal credibility. While counsel states that in 1994, when 5/6-17.1 was enacted, "Private Brand Labels [sic] had long been in use in Illinois", the statement is without any support of such longstanding use. In fact, even the examples counsel uses as Private Brand Labels (i.e. "Cooper's Hawk" and "Kirkland") were developed long after the legislature past the original version of 5/6-17.1 and even after 17.1 was amended in 1999. Without any specific examples that Private Brand Labels existed in 1994, how could the legislature have contemplated the Private Brand Label scenario when they passed the statute.

The third argument that counsel makes about "legislative acquiescence" to Private Brand Labeling is also ineffective because it is not on point. The cases that are cited in counsel's memorandum state that the State legislature acquiesced in an agency statement of the law because the legislature failed to act after the agency made its express interpretive statement. With Private Brand Labels, however, this Commission has made no such express statement or taken no affirmative act. Neither the Commission nor the Commission staff has passed a rule, published a trade practice policy, drafted an industry advisory or decided a case that permits Private Brand Labeling. If it did and then the legislature failed to act to correct the express statement for an extended period of time, then the legislature would have "acquiesced" to the agency's decision. In fact, up until the time that comments were made on the Commission staff rule proposal on private labeling, the overall concept of private labeling was unclear to the Commission and Commission staff. A Commission act now (if the Commission does take action) on the private labeling will determine to what the legislature will or will not acquiesce in the future. Until that point, there is no legislative acquiescence.

For the reasons cited in the above paragraphs, counsel's statutory construction arguments related to general serviceability and past practices cannot overcome the authority carried by the language of the Act itself which squarely prohibits retail exclusive brands.

b. Limits on Commission Rulemaking Authority do not Permit the Commission to Pass a Rule that Directly Contradicts the Statute.

If the construction of the statute alone was not enough of a hurdle to permit Private Brand Labeling then the Commission's limited authority to pass a rule that directly contradicts the Act make passing a rule even that much more difficult. While the legal staff for the Commission will be the first to argue that the Commission has significant leeway to interpret the Act in favor of "sound and careful control of alcoholic liquor", staff would stop short of such advice if an interpretation directly contradicts the language of the Act. In the past, staff has made every attempt to avoid direct contradictions of the Act when interpreting a statute, even though staff may advocate an aggressive position in cases of ambiguity or when the Act is silent.

In fact, even counsel's law firm has made strong arguments in the past that the Commission's rulemaking authority is limited to within the confines of the language of the Act. To cite just few statements made by the law firm from its opposition to the recent legal staff Brew Pub rule proposal:

> "An administrative body cannot extend or alter operation of a statute by exercise of its rule-making power";
>
> "To the extent a rule is in conflict with a statute, the rule is invalid";
>
> "Administrative agencies cannot extend substantive provisions of legislative enactment or create substantive rights through exercise of their rule-making powers"

(Zubin Kammula letter to Richard Haymaker; "Re: Proposed Brew Pub Rule; May 30, 2014).

The law firm made the same legal arguments in opposing Commission staff Private Label proposal.

If the Commission can recall, in the case of the Brew Pub Rule, it can be easily argued that there was some ambiguity in the Brew Pub definition about whether or not the law imposes a 50,000 gallon production maximum. Commission staff did not argue for a position that directly contradicted the Act. Commission staff took an aggressive position that both the language of the Act and policy dictated that there be a production limit on Brew Pubs. Nevertheless, even in the case when the Commission had some foundation to approve a rule that limited Brew Pub production, counsel's law firm argued that the Commission was not at liberty to use its discretion to craft a rule that **was not** in direct conflict with the Act. Somehow, counsel is now able to take an alternate position that the Commission has seemingly boundless authority to approve a rule that **is** in direct conflict with the language of the Act. While the Legal Staff agrees that Commission's discretionary authority in rulemaking is broad, it does not agree that the Commission can pass a rule contradicting the language of a statute.

D. Approving a Rule that Permits a Retailer's Name to be Placed on an Alcohol Beverage Label as Advocated in Paragraph 6 Could Violate the "Of Value" Prohibitions in the Liquor Control Act.

While not the subject of this memorandum, the Commission should not approve a rule (as advocated in Paragraph 6 of counsel's proposal) permitting a retailer's brand name to appear on a label of alcoholic liquor in which that label is sold to other retailers, without first discussing whether or not the concept violates the "of value" provisions of the Liquor Control Act. The California Alcohol Beverage Commission has recently prohibited the use of a retailer's name on a brand label for general distribution because the use of a retailer's name on a manufacturer's label constitutes free advertising to the retailer in violation of California's "of value" tied house prohibition. This interpretation of California law was opposed by counsel's own law firm. The case has been appealed and upheld through the California appellate system. Whether or not this Commission should enforce a similar prohibition is not to be debated here. Nevertheless, prior to passing a rule which expressly permits this activity, the Commission should consider the question.

E. <u>Conclusion</u>

It is opinion of the Commission staff that permitting Private Brand Labeling cannot be accomplished through the Commission's rulemaking authority because the Act currently expressly prohibits Private Brand Labeling. Far from requiring a legislative act to prohibit Private Brand Labeling, as suggested by private counsel, the Act already expressly prohibits it. Commission staff, therefore, offers its assistance in working with industry members and the legislature in drafting legislation that permits a form of Private Brand Labeling while still advancing the objectives of the Liquor Control Act.